

**MITCHELL COUNTY RURAL WATER DISTRICT NO. 3
BELOIT, KANSAS**

**FINANCIAL STATEMENTS WITH
INDEPENDENT AUDITORS' REPORT**

For the year ended October 31, 2012

**MITCHELL COUNTY RURAL WATER DISTRICT NO. 3
BELOIT, KANSAS**

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Mitchell County Rural Water District No. 3
Beloit, Kansas

We have audited the accompanying financial statements of the business-type activities of Mitchell County Rural Water District No. 3, as of and for the year ended October 31, 2012, which collectively comprise the District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the District's management. Our responsibility is to an express opinion on these financial statements based on our audit.

Except as discussed in the following paragraph, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the Kansas Municipal Audit Guide. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

Management has not adopted a methodology from reviewing the collectability of water revenues receivable and, accordingly, has not considered the need to provide an allowance for uncollectible amounts. Accounting principles generally accepted in the United States of America require that an adequate allowance be provided for uncollectible receivables, which would decrease the assets and fund balance and decrease the revenues. The amount by which this departure would affect the assets, net position, changes in net position is not reasonably determinable. In addition, management has not adopted a budget for the financial statements included in these report. Accounting principles general accepted in the United States of America require supplementary information with includes comparative results of operations with the adopted budget. The lack of the supplemental information does not affect the assets, liabilities, fund balance, revenue or expenses presented in these statements.

In our opinion, except for the effects of the matters described in the preceding paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of Mitchell County Rural Water District No. 3, as of October 31, 2012 and the results of operations and cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on page 3 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have

applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Pottberg, Gassman & Hoffman, Chd.

Pottberg, Gassman, & Hoffman, Chartered
Manhattan, Kansas
March 1, 2013

**MITCHELL COUNTY RURAL WATER DISTRICT NO. 3
BELOIT, KANSAS
OCTOBER 31, 2012**

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the Mitchell County Rural Water District No. 3 annual financial report presents an analysis of the District's financial performance during the year ended October 31, 2012. This information is prepared and presented in the conjunction with the annual audited financial reports prepared by the District's independent auditing firm.

The drought conditions of the past few years have continued through 2012 causing many of the ponds and wells to dry up. As a result, the district has added 5 new Benefit Units for watering cattle and reinstalled 3 meters in pre-existing locations. The district has a water conversation plan but has not had to implement it at this time. The district has also added over 16,000 feet of new main line and 7 new benefits units to residential sites.

In March of 2012 the district installed new office management and management policies. As a result, many large past due accounts were discovered and collected. Due to the collection of these past due accounts, the District was able to pay off their notes at the bank in August 2012 and in December 2012 pay ahead one year on the 2003 Revenue Refunding Bond Series F. The district office was also moved from Scottsville to Beloit along with the inventory and equipment which had been previously located at several different locations.

The annual water usage in 2012 was 96,206,000 gallons, an increase of 9,127,000 gallons from 2011. The District has an Emergency Water Plan.

All the substantial interest statements from board members were completed and returned to the district.

This financial report is designed to provide a general overview of the District's finances and demonstrate the District's commitment to public accountability. If you have any question about this report or would like to request additional information, contact the District office at 2031 N Independence, Beloit, KS 67420.

MITCHELL COUNTY RURAL WATER DISTRICT NO. 3
STATEMENT OF NET POSITION
OCTOBER 31, 2012

ASSETS

Current Assets

Cash and Cash Equivalents

Petty Cash	\$ 159
Checking - Tri Century Bank	282,945
SVB Checking	1,426
Savings - Farmway	10,305
SVB Savings	96,720
Certificate of Deposit - GSB	57,733
Certificate of Deposit - Farmway	50,000

Total Cash and Cash Equivalents 499,288

Accounts Receivable - Net 45,410

Inventory 30,599

Total Current Assets 575,297

Noncurrent Assets

Capital Assets

Water System and Equipment	4,077,286
Accumulated Depreciation	<u>(2,554,237)</u>

Total Capital Assets 1,523,049

Other Assets

Certificate of Deposit - Bond Reserve	61,782
Principal and Interest Reserve	58,790
Reserve Certificate of Deposit - GSB	109,866
Reserve Certificate of Deposit - Tricentury	27,363
Capital Credits - Rolling Hills	19,783
Payment Plans Receivable - net	42,347

Total Other Assets 319,931

Total Noncurrent Assets 1,842,980

TOTAL ASSETS \$2,418,277

LIABILITIES AND NET POSITION

Current Liabilities

Accounts Payable	\$ 52,347
Payroll Taxes Payable	1,406
Accrued Interest Payable	4,258
Sales Tax Payable	9
Current Portion of Bond Payable	110,000

Total Current Liabilities 168,020

Noncurrent Liabilities

Bond Payable	730,000
Less Current Portion	<u>(110,000)</u>

Total Noncurrent Liabilities 620,000

Total Liabilities 788,020

Net Position

Invested in Capital Assets, Net of Related Debt	793,049
Restricted for Bond Reserve	161,500
Unrestricted	675,708

Total Net Position 1,630,257

TOTAL LIABILITIES AND NET POSITION \$2,418,277

The notes to the financial statements are an integral part of this statement.

MITCHELL COUNTY RURAL WATER DISTRICT NO. 3
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND NET POSITION
FOR THE YEAR ENDED OCTOBER 31, 2012

OPERATING REVENUES	
Water Revenues - Members	\$ 416,362
Water Revenues - Commercial	161,723
City Surcharge	51,882
Monthly Minimum	189,024
TOTAL OPERATING REVENUES	<u>818,991</u>
OPERATING EXPENSES	
Water Purchases	204,411
Utilities and Phone	36,111
Repairs and Maintenance	18,648
Chemicals / Propane	4,525
Fuel / Diesel / Oil	2,615
Payroll and Payroll Taxes	85,003
Employee Benefits	14,550
Mileage	35,093
Legal and Audit	3,045
Contract Labor	10,192
Locates and Fees	940
Water Fees and Taxes	3,668
Rent	8,626
Insurance	13,823
Materials and Supplies	67,195
Office Expense	9,187
Miscellaneous	4,647
TOTAL OPERATING EXPENSES	<u>522,279</u>
INCOME FROM OPERATIONS BEFORE	
AMORTIZATION AND DEPRECIATION	296,712
Depreciation	<u>(103,008)</u>
OPERATING INCOME (LOSS)	<u>193,704</u>
NON-OPERATING REVENUES AND EXPENSES	
Debt Service Revenue	83,065
Interest Income	5,210
Penalty Revenue	19,490
Income from Payment Plans	42,347
Miscellaneous Income and Reimbursement	41,395
Dividends	3,692
Bad Debt Expense	(6,399)
Loss on Disposal / Sale of Assets	(4,268)
Interest Expense	<u>(31,910)</u>
TOTAL NON-OPERATING REVENUES (EXPENSES)	<u>152,622</u>
INCOME (LOSS) BEFORE CONTRIBUTIONS	<u>346,326</u>
Capital Contributions	15,000
CHANGE IN NET POSITION	<u>361,326</u>
NET POSITION, BEGINNING	1,344,155
PRIOR PERIOD ADJUSTMENT	<u>(75,224)</u>
NET POSITION, ENDING	<u><u>\$ 1,630,257</u></u>

The notes to the financial statements are an integral part of this statement.

MITCHELL COUNTY RURAL WATER DISTRICT NO. 3
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED OCTOBER 31, 2012

CASH FLOWS FROM OPERATING ACTIVITIES:

Cash Received from Customers	\$ 783,183
Cash Payments to Suppliers for Goods and Services	(364,999)
Cash Payments to Employees and Professional Contractors for Services	(116,004)
Net Cash Provided (Used) by Operating Activities	<u>302,180</u>

CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:

Acquisition and Construction of Capital Assets	(9,742)
Principal Paid on Bond	(110,000)
Principal Paid on Notes	(67,939)
Interest Paid on Bonds and Notes	(32,552)
Other Capital Activities	56,345
Debt Service Revenue and Penalties	97,262
Bond and Note Reserve Funds	(11,581)
Net Cash Provided (Used) by Capital and Related Financing Activities	<u>(78,207)</u>

CASH FLOWS FROM INVESTING ACTIVITIES

Investment Income	8,902
Net Cash Provided (Used) by Investing Activities	<u>8,902</u>

Net Increase (Decrease) in Cash and Cash Equivalents	232,875
Cash and Cash Equivalents at January 1	266,413
Cash and Cash Equivalents at December 31	<u>\$ 499,288</u>

Reconciliation of Operating Income to Net Cash Provided by Operating Activities

Income from Operations	\$ 193,704
Depreciation	103,008
Increase in Receivables	(35,808)
Decrease in Inventory	35,590
Increase in Payables	5,686
Net Cash Provided by Operating Activities	<u>\$ 302,180</u>

The notes to the financial statements are an integral part of this statement.

MITCHELL COUNTY RURAL WATER DISTRICT NO. 3
BELOIT, KANSAS
OCTOBER 31, 2012

NOTES TO THE FINANCIAL STATEMENTS

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization Description

Mitchell County Rural Water District No. 3, Beloit, Kansas (District), was incorporated January 11, 1973 as a quasi-municipal Corporation under Kansas Statute K.S.A. 82a-612 et seq., for the purpose of providing a water supply system for the landowners within the area of the District. The following is a summary of the District's significant accounting policies.

Basis of Accounting

The District's financial information is reported on the accrual basis of accounting, in conformity with accounting principles generally accepted in the United States of America. Revenues are recognized when they are earned and expenses are recognized when they are incurred.

Operating revenues are those that are generated from primary operations. All other revenues are reported as non-operating revenues. Operating expenses are those expenses that are essential to the primary operations. All other expenses are reported as non-operating expenses, such as reimbursements for joining the water district.

Statement of Cash Flows

For purposes of the statement of cash flows, the District considers all bank deposit accounts, money market accounts and certificates of deposits classified as current assets to be cash and cash equivalents. Certificates of deposit with maturities of longer than three months can still be used by the District to meet current liabilities if they wish to pay any applicable penalties.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain amounts and disclosures. Accordingly, actual results could differ from those estimates.

Capital Assets

Capital assets purchased for \$500 or more are capitalized at cost. Depreciation is recorded based on the estimated useful life of each asset using the straight-line method. The estimated useful lives of the assets range from 5 to 50 years.

Inventory

Inventory is stated at cost and consists of pipe, valves, meters, and other items needed to repair or add water lines.

Accounts Payable

Accounts payable consist of invoices received from vendors for services or products received during the period but not yet paid.

Operating Activities

Operating revenues result from exchange transactions associated with the activity of the water district. Each party receives and gives up essentially equal values. Non-operating revenue results from non-exchange transactions such as investment earnings.

MITCHELL COUNTY RURAL WATER DISTRICT NO. 3
BELOIT, KANSAS
OCTOBER 31, 2012

NOTES TO THE FINANCIAL STATEMENTS

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

Taxes

The District is exempt from federal and state income taxes.

NOTE 2 – DEPOSITORY SECURITY

K.S.A. 9-1401 establishes the depositories which may be used by the District. The statute requires banks eligible to hold the District's funds have a main or branch bank in the county in which the District is located, or in an adjoining county if such institution has been designated as an official depository, and the banks provide an acceptable rate of return on funds. In addition, K.S.A. 9-1402 requires the banks to pledge securities for deposits in excess of FDIC coverage. The District has no other policies that would further limit interest rate risk.

K.S.A. 12-1675 limits the District's investment of idle funds to time deposits, open accounts, and certificates of deposit with allowable financial institutions; U.S. government securities; temporary notes; no-fund warrants; repurchase agreements; and the Kansas Municipal Investment Pool. The District has no investment policy that would further limit its investment choices.

Concentration of credit risk. State statutes place no limit on the amount the District may invest in any one issuer as long as the investments are adequately secured under K.S.A. 9-1402 and 9-1405.

Custodial credit risk – deposits. Custodial credit risk is the risk that in the event of a bank failure, the District's deposits may not be returned to it. State statutes require the District's deposits in financial institutions to be entirely covered by federal depository insurance or by collateral held under a joint custody receipt issued by a bank within the State of Kansas, the Federal Reserve Bank of Kansas City, or the Federal Home Loan Bank of Topeka, except during designated "peak periods" when required coverage is 50%. The District has no designated "peak periods."

At December 31, 2012 the District's carrying amount of deposits was \$756,930 and the bank balance was \$753,958. Balances at two banks exceeded the Federal Depository Insurance Corporation (FDIC) limit and those balances in excess of FDIC limits were each more than 5% of the total bank balances, which results in a concentration of credit risk per GASBS 40, paragraph 11. Of the bank balance, \$574,006 was covered by federal depository insurance and \$179,952 was unsecured.

NOTE 3 – ACCOUNTS RECEIVABLE

Accounts receivable are customer water bills that have been invoiced but remain unpaid. The District does not have an accurate past payment history to determine the allowance for uncollectible accounts as of October 31, 2012, therefore no allowance for bad debts has been recorded and bad debts are directly written to expense when management considers them uncollectible. The direct write-off method is not acceptable for the purposes of generally accepted accounting principles. This departure does not result in a material misstatement of the financial statements.

MITCHELL COUNTY RURAL WATER DISTRICT NO. 3
BELOIT, KANSAS
OCTOBER 31, 2012

NOTES TO THE FINANCIAL STATEMENTS

NOTE 3 – ACCOUNTS RECEIVABLE, CONTINUED

Prior year water revenues due from customers have not been invoiced and paid timely. The District worked with customers in 2012 to determine the amount of past-due accounts and established payments plans. Because the District has implemented a policy to disconnect these customers should they miss a payment, management has set the allowance account for these balances at zero. These past due amounts are listed on the Statement of Net Position, Other Assets as Long-Term Payment Plans Receivable.

The following is an aging of accounts receivable for the District at December 31, 2012:

<u>Accounts Receivable</u>	<u>Total</u>	<u>Current</u>	<u>31-60 days</u>	<u>Over 60 Days</u>
Customers	\$87,757	\$39,778	5,632	\$42,347

NOTE 4 – CAPITAL ASSETS

Capital assets purchased or built are capitalized at cost. Depreciation is recorded based on the estimated useful life of each asset using the straight-line method.

<u>Balance</u> <u>November 1, 2011</u>	<u>Accumulated</u> <u>Depreciation</u>	<u>Purchases</u>	<u>Disposals</u>	<u>Depreciation</u>	<u>Prior Period</u> <u>Adjustment</u>	<u>Balance</u> <u>October 31, 2012</u>
<u>\$ 4,172,899</u>	<u>(\$2,553,952)</u>	<u>\$10,542</u>	<u>(\$5,057)</u>	<u>(\$103,008)</u>	<u>\$1,625</u>	<u>\$1,523,049</u>

NOTE 5 – BUDGETS AND BUDGETARY ACCOUNTING

Per K.S.A. 82a-628, the Board is required to annually prepare an estimated budget for the coming year. The Board currently does not prepare an annual budget.

NOTE 6 – BOND PAYABLE

On June 15, 2003, the Kansas Rural Water Financial Authority issued \$1,615,000 of bonds on behalf of the District with an effective interest rate of 3.5% to refund their Revenue Bonds Series 1995, dated July 1, 1995 in the amount of \$1,415,000. Interest payments are due semi-annually on March 1st and September 1st. Principal payments are due on September 1 maturing in 2017.

2003 Bonds Payable Information:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total Payment</u>
2013	110,000	25,550	135,550
2014	115,000	21,700	136,700
2015	125,000	17,675	142,675
2016	125,000	13,300	138,300
2017	255,000	8,925	263,925
Totals	<u>\$ 730,000</u>	<u>\$ 87,150</u>	<u>\$ 817,150</u>

MITCHELL COUNTY RURAL WATER DISTRICT NO. 3
BELOIT, KANSAS
OCTOBER 31, 2012

NOTES TO THE FINANCIAL STATEMENTS

NOTE 6 – BOND PAYABLE, CONTINUED

A bond reserve is required to be maintained in an amount lesser of 10% of the bond issue amount (\$161,500) or the average annual principal and interest on all outstanding bonds (\$163,430). For the bond reserve, \$61,782 and \$27,363 are segregated in Certificates of Deposit at Tri-Century bank and \$109,866 is segregated in a Certificate of Deposit at Guaranty State Bank for a total of \$199,011 in reserve.

NOTE 7 – NOTES PAYABLE

In August 2012, the District paid off their remaining loan balances at Guaranty State Bank for a total of \$67,939 in principal and \$3,152 in interest.

NOTE 8 – DEBT SERVICE RATIO

The bond issue covenants require the District to maintain net revenues in an amount that will be not less than 125% of the debt service requirements required to be paid in such fiscal year on all bonds outstanding.

Change in Net Position	\$ 361,326
Interest Expense	31,910
Amortization and Depreciation	103,008
Capital Contributions	(15,000)
Total Revenue Available for Debt Service	<u>\$ 481,244</u>
Debt Service Requirements	\$ 139,400
Required Percentage	125%
Net Revenue Required	<u>174,250</u>
Net Revenue Surplus (deficit)	<u>\$ 306,994</u>

NOTE 9 – LONG-TERM DEBT

The following schedule shows the changes in long-term debt and related maturities.

<u>Description</u>	<u>Date Issued</u>	<u>Original Amount</u>	<u>Outstanding 11-1-11</u>	<u>Principal Payments</u>	<u>Outstanding 10-31-12</u>	<u>Interest Paid In 2012</u>
2003 Bond	06/15/13	<u>1,615,000</u>	<u>840,000</u>	<u>110,000</u>	<u>730,000</u>	<u>29,400</u>

NOTE 10 - LITIGATION

There were no legal actions involving the District as of October 31, 2012.

NOTE 11 - CONCENTRATIONS

All of the District's water is purchased from Mitchell County Rural Water District No. 2.

NOTE 12 – STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY

An annual budget was not prepared by the District which is a violation of Kansas Statute K.S.A. 82a-628.

MITCHELL COUNTY RURAL WATER DISTRICT NO. 3
BELOIT, KANSAS
OCTOBER 31, 2012

NOTES TO THE FINANCIAL STATEMENTS

NOTE 12 – STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY, CONTINUED

Deposits at Tri-Century bank in the amount of \$179,952 were in excess of Federal Deposit Insurance Corporation limits and therefore, unsecured as of October 31, 2012 which is a violation of Kansas Statute K.S.A. 9-1402.

The District did not have evidence of all custodial security interest agreements for their pledged securities which is a violation of Kansas Statute K.S.A. 9-1405.

The District is in violation of Kansas Statute K.S.A. 75-4305 which requires elected officers, appointed public officers, and certain employees to have filed written reports disclosing substantial interests.

NOTE 13 - COMPENSATED ABSENCES POLICY

The District does not have a formal sick or vacation leave policy for their employees; therefore, the value of compensated absences as of October 31, 2012 is not reflected in the financial statements.

NOTE 14 – RISK MANAGEMENT

Mitchell County Rural Water District No. 3 is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. To insure against risk of these types of losses, the District has purchased commercial insurance coverage from Fouts Insurance Agency, Inc. and Citizens State Agency in Beloit, Kansas. Settled claims resulting from these risks have not exceeded commercial coverage in the past three fiscal years.

NOTE 15– RELATED PARTIES

All the members of the board of directors and all employees are water district customers. The only material transactions were water purchases consummated on the same terms as all other water customers. All were current at year-end.

NOTE 16– PRIOR-PERIOD ADJUSTMENTS

During the current year, it was determined that certain prior year amounts were incorrectly recorded. Bond issue costs that had previously been paid off remained on the books, fixed assets and accumulated depreciation had not been correctly recorded, and certain accruals and pre-paid expenses had not been properly recorded. Adjustments totaling \$464,153 were made to correct these errors, having a net affect of decreasing fund balance by \$75,224.

NOTE 17 – SUBSEQUENT EVENTS

In December 2012 the District utilized the collection of past due accounts to pay an additional \$100,000 on the 2003 Revenue Refunding Bond Series F. The district has evaluated subsequent events through March 1, 2013, the date the financial statements were available to be issued.